



THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE

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340-774-0001

February 20, 2009

Nikolao Pula
Director of Office of Insular Affairs
Chair, Interagency Group on Insular Affairs
Room 4310 Main Interior Building
Department of the Interior
1849 C Street, N.W.
Washington, D.C. 20240

Dear Director Pula:

Thank you for the opportunity to propose agenda items for discussion at the meeting of the Interagency Group on Insular Affairs (IGIA) and Territorial governors scheduled for February 24, 2009. We have identified six issues, which are of critical importance to the economic development and fiscal independence of the Virgin Islands, for the IGIA agenda.

1. Coordination of the Implementation of State Fiscal Stabilization Fund, as authorized by the American Recovery and Reinvestment Act of 2009
2. Removal of Cap on Rum Excise Taxes Returned to the Virgin Islands
3. Elimination of Cap on Medicaid, S-CHIP and Low Income Home Energy Assistance Program Funding
4. Earned Income Credit Cost Sharing
5. Establishment of a full Border Patrol Unit in the Virgin Islands
6. Expansion of the Virgin Islands Role in the Caribbean

Thank you for your consideration of these critical issues.

Sincerely,

A handwritten signature in black ink, appearing to read "John P. de Jongh, Jr.", with a stylized flourish at the end.

John P. de Jongh, Jr.
Governor

Thank you for the opportunity to raise the following six issues, which are of critical importance to the economic development and fiscal independence of the Virgin Islands, at the February 24, 2009 meeting of the Interagency Group on Insular Affairs (IGIA). The following is a brief overview of these proposed issues, along with a summary of requested administrative or legislative action:

1. Coordination of the Administration of the State Fiscal Stabilization Fund for the Territories under the American Recovery and Reinvestment Act of 2009.

The American Recovery and Reinvestment Act of 2009 (ARRA) provides \$53.6 billion for grants to States and Territories (Title XIII), Division A) for purposes of providing fiscal relief and preventing State/Territorial budget cuts to education and other essential public services as a result of declining State/Territorial revenues. ARRA includes a number of specific requirements for participation by individual States. In recognizing the unique needs of the small Territories of the United States, ARRA requires that the Secretary of Education set aside up to one-half of one percent of the total amount appropriated, or approximately \$268 million, for the small Territories and provides additional flexibility for the Territories in the administration of the State Fiscal Stabilization Funds. Section 14001(a) of ARRA specifically provides that “[f]rom the amount [\$53.6 billion] appropriated . . . , the Secretary of Education shall first allocate areas on the basis of their respective needs, as determined by the Secretary, in consultation with the Secretary of the Interior, for activities consistent with this title under such terms and conditions as the Secretary may determine.”

The needs of the Government of the Virgin Islands exceed even the generous total funding allocated to the outlying areas under Section 13001(a). The Government also has the capacity to expend the total amount of funding set aside under Section 13001(a). In determining the allocations between the small Territories, therefore, the Secretary should allocate to the Virgin Islands no less than a one-fourth share of one-half of one percent of the total amount appropriated, or \$67 million. To the extent that any of the other Territories are not able to obligate or expend the funds allocated under Section 13001(a) within the time frames set forth in ARRA, the Government of the Virgin Islands submits that the Secretary should first redistribute and unobligated or unexpended funds to the Virgin Islands and other U.S. Territories which have met their obligations under the ARRA.

In addition, ARRA requires that the Secretary of Education shall consult with the Secretary of the Interior in determining the respective needs of the Territories and establishing the terms and conditions of funding under the State Fiscal Stabilization Fund. In particular, this requirement. Congress recognized that the Territories have unique needs that may be better understood by the Department which has greater historical experience with the island Territories. In particular, the provision signals Congress’ intent that the Secretary has discretion to provide additional flexibility to the governments of the Territories in permitting funds to be used for projects and services other than those mandated or authorized for States.

Accordingly, the Government of the Virgin Islands respectfully requests that the Secretary of the Interior undertake a leading role in the administration of the State Fiscal

Stabilization Fund for the Territories to ensure that the intended flexibility for the Territories is provided.

2. Removal of Cap on Rum Excise Taxes Returned to the Virgin Islands.

As part of its long-standing tax relationship with the U.S. Virgin Islands, Congress historically provided that all federal excise taxes on all products — including rum — manufactured in the Territory shall be returned, or “covered-over,” to the local treasury. In 1984, Congress imposed, for reasons no longer relevant, a cap on the cover-over rate applied to Virgin Islands rum shipped to the United States.

Congress has subsequently increased the rum excise tax to \$13.50 per proof gallon, but has continued to provide that the amount to be covered-over to the Virgin Islands is limited to a base rate of \$10.50 per proof gallon. Congress increased the cover-over rate to \$13.25 per proof gallon on a temporary basis in 1999 and has regularly extended the temporary rate since that time. In the absence of Congressional extensions, the cover-over rate would return to the base rate of \$10.50 per proof gallon. Indeed, the last extension of the cover-over rate expires on December 31, 2009, and the rate must now be extended before the end of this year to avoid any disruption in cover-over payments to the Virgin Islands government.

These temporary extensions of the current \$13.25 per proof gallon rate, while welcome, nonetheless cause budget planning problems for the Territory’s government. The revenue stream provided by the rum excise tax cover-over is committed to the payment of the Government’s obligations on its bonded indebtedness. In order to provide greater certainty to U.S. bond holders, as well as for the Territory’s budget, Congress should remove the cap on the cover-over rate and authorize the cover-over of the full amount of rum excise taxes to the Virgin Islands.

It is generally accepted that there are no policy reasons that stand in the way of Congressional action to remove the cap and allow the Territory to receive the full amount of the tax imposed on Virgin Islands rum. The tax was imposed, in the first place, not to raise revenues for the Federal Government, but rather to ensure a level playing field for domestically produced distilled spirits with which Virgin Islands rum competes in the U.S. market. Rather, it would appear that the reasons blocking a permanent solution to this problem up until now is a more practical one: under the Congressional budget rules, a Congressionally initiated legislative change must be “offset” with other revenues, but a permanent solution proposed by the Administration as part of its annual budget proposals to the Congress does not. The Government of the Virgin Islands therefore respectfully requests that the IGIA work to include a permanent solution to the rum tax formula by removing the rum tax cap in the Administration’s next budget submission to the Congress.

3. Equal Treatment of Territories in Individual Benefit Programs: Elimination of Discriminatory Caps on Medicaid Funding; S-CHIP Funding and the Low Income Home Energy Assistance Program.

a. Medicaid. The ability of the Virgin Islands Government to assure adequate health care for Island residents is hampered by the discriminatory Federal Medicaid

Assistance Participation (FMAP) rate and the statutory cap on federal Medicaid funds provided to the Virgin Islands and the other U.S. Territories. Medicaid is a Federal-State program to provide for the health care needs of the poorest and neediest persons in our country. In the U.S. Virgin Islands and the other U.S. Territories, however, Medicaid is not an entitlement program. Rather, the Virgin Islands and other U.S. Territories receive a capped funding amount for its Medicaid-eligible population. In addition, the federal amounts are subject to the lowest FMAP rate (50 percent) under the Medicaid statute. If the Virgin Islands were treated as a State, the Territory would qualify for an 83 percent FMAP rate with a 17 percent local matching requirement. These federal limitations are discriminatory and prevent the Virgin Islands Government from adequately meeting the health care needs of its Medicaid-eligible population.

The quality of health care and the amount of federal support should not depend on whether an individual lives in California, Alaska or in a United States Territory. While Congress just approved, as part of the American Recovery and Reinvestment Act of 2009, a temporary increase in the amount of Medicaid funds provided to the Virgin Islands, such increase only narrows the gap between the funds allocated to the Virgin Islands and the funds the Virgin Islands would be entitled to if the Virgin Islands were treated as a State under the Medicaid formula. Accordingly, the Government of the Virgin Islands respectfully requests the Administration to support, through the IGIA process, further improvements in the Medicaid formula and to ensure that the neediest residents in the Territories receive no less favorable treatment than the neediest residents in the United States.

b. S-CHIP. Artificial funding caps also seriously impede the ability of the Virgin Islands and the other U.S. Territories to address the health care needs of uninsured children under the State Children's Health Insurance Program (S-CHIP). S-CHIP is a State-Federal partnership program that was created by Congress in 1997 to increase health insurance coverage for low-income children. Because of inadequate funding levels (\$2.2 million in S-CHIP funding for FY 2009), the Virgin Islands has never been able to establish a viable S-CHIP program for its low-income and uninsured children. Instead, under applicable regulations, the Virgin Islands has been permitted to combine its limited S-CHIP funding with funding under Medicaid to provide health care for Medicaid-eligible children. However, due to caps in Medicaid funding for the U.S. Territories, these combined resources are entirely inadequate to cover the number of eligible children. Moreover, unlike funding for the States, funding for the U.S. Territories is based on capped flat dollar amounts that do not take into account the health care needs of low-income children in the Territories.

Like other U.S. Territories, the Virgin Islands has a significant population of low-income children in need of health care. According to some estimates, one in three children in the Virgin Islands lives with a family whose income is below the Federal poverty level – a child poverty rate higher than any U.S. State. Currently, to qualify for assistance, eligible children must reside with families that earn no more than \$8,500 – less than half the federal poverty level. However, due to the inadequacy of its combined S-CHIP and Medicaid resources, the Virgin Islands is unable to provide health care assistance to all children even in this very low income range.

The V.I. Department of Health has estimated that it would require approximately \$12 million in S-CHIP funding to adequately serve the health care needs of uninsured children in the Virgin Islands. Accordingly, the Virgin Islands respectfully requests that the IGIA work to increase S-CHIP funding for the U.S. Territories to address the very high levels of childhood poverty in these jurisdictions.

c. LIHEAP. Discriminatory allocation formulas also prevent the U.S. Virgin Islands and other U.S. Territories from benefiting equitably from the Federal Low Income Home Energy Assistance Program (LIHEAP). LIHEAP is a block grant program designed to assist low-income households in meeting their immediate home energy needs. The program's particular focus is on households with the lowest incomes that pay a high proportion of household income for home energy. Although LIHEAP is commonly viewed as a home heating program, it is employed in all regions of the country to assist low-income persons with the full range of household energy needs.

The Virgin Islands, like the other U.S. Territories, has particularly high levels of poverty and high energy costs. The Virgin Island's poverty rate of 32 percent (2000 Census) is some two-and-one-half times the national poverty rate. At the same time, as an island territory that must rely on imported oil and provide power generation to a number of islands, the Virgin Islands has among the highest energy costs of any U.S. jurisdiction. Based on these factors, under equitable allocation formulas, the Virgin Islands and other U.S. Territories should benefit significantly from LIHEAP funding. However, due to a regulatory cap on LIHEAP allocations, the Virgin Islands and other U.S. Territories receive far less in LIHEAP funding on a per capita basis than many States. In recent years, for example, the Virgin Islands has received only \$90,000 out of a total of almost \$2 billion in LIHEAP funding. The LIHEAP statute authorizes the Department of Health and Human Services (HHS) to provide the U.S. Territories with funding of between one-tenth of one percent and one-half of one percent of total LIHEAP funding for each fiscal year. However, under HHS regulations, the U.S. Territories have been capped at 0.14 percent of total funding since 1981, despite the significant poverty in, and energy needs of, the U.S. Territories. Accordingly, the Virgin Islands respectfully requests that the Administration support, through the IGIA process, an increase in the overall HHS LIHEAP allocation percentage for the U.S. Territories which fairly reflects their demonstrated needs for low-income energy assistance .

4. Earned Income Credit Cost Sharing.

Congress enacted the Earned Income Credit (EIC) as a refundable tax credit to assist low-income workers with little or no income tax liability. In particular, one of the principal purposes of the EIC is to offset the disproportionate burden of FICA (Social Security) taxes on such low-income persons. In the case of the Territorial "mirror code" jurisdictions, the cost of the EIC is a significant fiscal burden on local governments, a burden which has been exacerbated by recent increases in the value of the credit. To offset, in part, the burden of this unintended result, the Government of the Virgin Islands has proposed (with the support of the Government of Guam) an EIC cost-sharing arrangement based on existing Internal Revenue Code provisions.

Under this proposal, Insular Area governments with “mirror code” requirements would be authorized to make mandatory the employer “advance payment” program under section 3507 of the Code. Under this procedure, an employer would advance pay to qualifying employees an amount equal to 60 percent of such employee’s estimated EIC, which amount would be credited against the employer’s quarterly payments of FICA contributions pursuant to federal form 941 (relating to FICA payments for employees). The employer would thus be made whole on a quarterly basis, and the Federal Government would assume responsibility for approximately 60 percent of the Territory’s EIC obligations, with the local “mirror code” jurisdiction retaining responsibility for the remaining 40 percent (which would be paid or credited to the taxpayer upon the processing of the taxpayer’s income tax return by the local taxing authority). Alternatively, the taxing authority in each mirror code jurisdiction would be authorized to certify the total amount of EIC “paid” in any tax year and the Treasury would be required to reimburse such taxing authority 60 percent of such amount out of total FICA payments made to the Treasury from such jurisdiction.

While the Government of the Virgin Islands submits that the IRS has adequate legal authority to execute a cost-sharing agreement between the United States and the mirror code jurisdictions, the Government understands that, as a practical matter, legislation may be necessary to clarify such authority and to facilitate such cost-sharing arrangements. Accordingly, the Virgin Islands respectfully requests that the Administration support such cost-sharing arrangement, either through administrative action or through legislation.

5. Establishment of a Fully-Staffed and Equipped Border Patrol Unit in the Virgin Islands.

While the Customs and Border Protection Service (CBP) has announced support for the expansion of the CBP presence in the Virgin Islands, there is still no full Border Patrol station in the Virgin Islands, with the closest station responsible for protecting the Territory’s borders and coast line located in Puerto Rico. The station in Puerto Rico, however, must focus primarily on the hundreds of miles of coastline in that part of the Caribbean, leaving the coastline and coastal waters of the Virgin Islands largely exposed and vulnerable to human smuggling and drug trafficking. As a result, international smugglers and organized crime have been increasingly utilizing the Virgin Islands as a major transshipment point into the United States. In addition to the implications for national and regional security, the scourge of smuggling and illegal drug trafficking has had a direct impact on the crime rate and on the quality of life in the Territory. The Government of the Virgin Islands therefore requests the support of the IGIA for the establishment of a fully staffed and equipped Border Patrol Unit in the Virgin Islands.

6. Expansion of the U.S. Virgin Islands Role in the Caribbean.

The Virgin Islands plays a major role in the economic, social and cultural life of the English-speaking Caribbean. The Virgin Islands economy attracts investment and workers from across the region, while Virgin Islands businesses export products and services. The University of the Virgin Islands educates students from virtually island nation in the region, including many who have become leaders and elected officials in their home countries. The Virgin Islands has thus been both an incubator and a showcase for American democracy. Yet, despite its

prominence in the region, the Virgin Islands plays no formal role in the development of U.S. policy in the Caribbean, nor does it participate, even as an observer, in any of the regional governmental organizations, such as the Organization of the Eastern Caribbean States. The Government of the Virgin Islands believes it can, and should, play a more active role in the region, including participation in regional organizations, in order to facilitate regional policies that can lead to stronger economic growth, increased trade and strengthened cultural ties. Accordingly, the Government of the Virgin Islands respectfully requests that the Administration, through the IGIA process, support an expanded role for the Virgin Islands in the Caribbean region.

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Thank you for your consideration of these critical issues.